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December 04, 2006

[Not as bad as they wanted you to believe](#)

by J. Christoph Amberger

Funny how that always happens: U.S. GDP growth for a particular quarter is announced and the talking heads are falling all over themselves with apocalyptic visions of U.S. economic decline. (It doesn't matter if the announced numbers come it at 0.9% growth or 3.9% growth.)

A few weeks later, the government bean counters announce the first update -- usually an upward correction -- and all you hear from the chattering classes is a noncommittal "oh!" After all, they're already predicting dramatically lower growth for the next quarter and can't be bothered with reality.

The numbers for third-quarter GDP growth did not deviate from this pattern. The Commerce Department announced that the U.S. economy expanded at a revised 2.2% annual rate from July through September.

That's a considerable difference from the 1.6% growth estimate issued last month. I bet that once the Commerce Department final tally comes in on Dec. 21, we'll be closer to 2.5% growth for the quarter.

In Europe, they would call that a "roaring recovery."

Consumer spending expanded at a 2.9% annual clip.

-- One of the detracting factors from stronger GDP growth is the decline of the U.S. housing and construction industry.

Residential construction fell at an 18% annual rate in Q3.

(However, business fixed investment, which includes commercial construction as well as on equipment and software, rose at a 10% annual rate last quarter.) October sales of new homes declined another 3.2% to an annual pace of 1.004 million.

And yet, the supply of unsold homes at the current sales pace rose to only seven months' worth.

Pre-tax corporate earnings -- adjusted for the value of inventories and capital depreciation, known as profits from current production -- rose \$66.2 billion, or 4.2%. That's three times the rate of Q2!

Again, the numbers tell us that while we certainly cannot expect economic growth to continue at the same clip as in previous quarters, reports of an imminent economic slowdown are greatly exaggerated.

Which means you should use temporary dips in the major indices as buying opportunities.

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[Money people vote with their dollars](#)

by J. Christoph Amberger

Once again, the euro rose 0.7% against the dollar, to \$1.3247. The euro is now just a nickel away from setting another record against the greenback since January 2002, when it replaced the other European currencies.

(I like to point out that to get credible data for exchange rates prior to January 1, 2002, you'd have to recalculate historic exchange rates based on the individual national currency based on their official exchange rate at the point of conversion.)

The British pound sterling, whose history is untainted by the euro and can be looked at without a calculator in hand, rose to its highest level against the dollar since its ejection from the European Exchange Rate Mechanism in September 1992.

So what's going on? The numbers sure don't provide a reason for bearishness.

Inflation in U.S. personal consumption expenditure excluding food and energy, which is the Fed's preferred inflation benchmark, held steady in October at 2.4% year-on-year. GDP growth for the third quarter was just upgraded by a hefty margin to 2.2%, a clip that EU economists would consider "strong growth" if it happened in Europe. The U.S. budget deficit is down to 1.9% of GDP -- lower than that of most European countries. The trade deficit was actually shrinking. Oil prices are down; incomes and spending up.

(Then, of course, numbers have never stood in the way of pure-minded bearishness!)

So what has changed over last month, when GDP growth actually looked a good deal paltrier?

I have an inkling that 49% of my readers won't like.

I say its politics. Money people vote with their money, independent of nationality. Money is the foremost indicator of where people think an economy is headed. And while the foreign press is cooing over the new power constellation in Congress, foreign and domestic investors are indicating that they fear a Democratic Congress in bad for business.

They may have a point. Luckily, the U.S. economy still has two things going in its favor: the strength of the Bush Boom and the short attention span of global finance.

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[The meaning of grills](#)

by J. Christoph Amberger

“They’re called grills,” my oldest son informed me as we pulled away from the drive-up counter of the local Golden Arches.

I was confused. “Yeah, well. It’s a fast-food place. Of course they have ‘griddles.’”

“No, Dad. His teeth. Didn’t you notice his teeth?”

Truth be told, I hadn’t. To me, the cashier had been just another kid with lots of metal on his teeth that got in the way of proper articulation of consonants and vowels.

“Those aren’t braces, Dad,” my son lectured me. “They’re called grills. They’re bling for your teeth.”

“You mean that they voluntarily wear some kind of orthodontic apparatus trying to look cool?” I was incredulous.

“Yeah. Joe from school is getting some, too. His parents are paying for them.”

That boggled the mind, because I know both Joe and his parents.

“How ‘bout you? Do you want to get some, too?”

To his credit, my son’s response was entirely credible: “You kidding me? I’ll be glad when I get those things out.” And he flashed a few thousand dollars’ worth of braces at me.

“Good,” I said. “Because I wouldn’t have gotten you any.”

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[Midlife Crisis? What Midlife Crisis?](#)

by J. Christoph Amberger

When men hit a certain age, they’re supposed to go a bit off kilter. They start running marathons or buy an overpriced red sports car. Others splurge on rejuvenation and start reforesting their balding pates with neat rows of second-growth (often secondhand) hair follicles that, with proper fertilization, can grow up to be nifty comb-overs.

Since I’m getting close to that age group, I’ve been trying to locate a suitable midlife crisis for the purpose of developing a compensatory obsession.

It’s not an easy undertaking, mind you. I find running tedious (at least as long as you don’t get to hit someone while doing it). I’ve never much cared about cars. And as to the ravages time has inflicted on my cranial foliage, I figure no hair plug would survive the scraping of the fencing mask being put on and removed a few dozen times each week... let alone a freezing night of Boy Scout camping.

The closest I got to living out my own budding personal crisis the other day was the acquisition of a bottle of aftershave. For decades, I had done without. So pardon me if my choice was an old favorite of the ‘80s: Paco Rabanne. Way back then, I was assured that the masculine sophistication it exuded was a chick magnet.

If it still is I will never find out. The first time I splashed it on, the best wife of 'em all made retching noises: "Did somebody spill something?"

Dignified, I responded that this was indeed the aroma that made me irresistible to her back in 1984. She remained unimpressed: "Well, it actually makes me nauseous now."

Not one to throw out a perfectly good bottle of chick magnetism that cost \$40, I continued to use the stuff when going to work later than her or on business travel (I noticed it also repels mosquitoes) until Monday morning, when the bottle had mysteriously disappeared from the top of my dresser.

I heard the words "inconsiderate," "stench," and "queasy" in her explanation, but since women statistically speak two thirds more than men do, and men only hear 33% of what women say, I couldn't help thinking that she may really have disliked my aftershave.

That means only one thing: It's back to the drawing board for my midlife crisis. A red convertible may do the trick. If I only could find one in dark blue, with four doors and a hatchback.

You know, like a station wagon...

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Neo-Com Reaffirmation

by J. Christoph Amberger

Venezuelan President Hugo "El Comandante" Chavez was re-elected for a second 6-year term on Sunday, campaigning on a neo-Communist platform that stresses redistribution of wealth and opposition to the United States.

Chavez garnered 61 percent of the vote, his challenger Manuel Rosales 38%.

Being the foremost neo-Com agitator in the region, Chavez continues a streak of leftist election victories in the Americas in the last month and a half.

Venezuela has now cemented its role as a cornerstone of Latin American petro- and narco-Communism. Chavez vowed to use his renewed mandate to abolish presidential term limits and create a single-party system to secure his power for decades.

Among its most outspoken allies in the region are Evo Morales of Bolivia and Rafael Correa of Ecuador (who won a run-off election last week). Both countries are heavily dependent on financial assistance from Chavez petrodollar riches.

Socialists Luiz Inacio Lula da Silva in Brazil and reborn Sandinista head honcho Daniel Ortega in Nicaragua have won recent presidential elections. Both still pursue a less contentious course than Chavez. In Mexico, the Chavezian loser of the recent presidential election has declared a parallel government.

Here's what you can expect from Venezuela in the next three years:

- * a complete re-nationalization of the oil industry and other key economic sectors (eventually leading to a drop in oil production and exploration), the establishment of a government monopoly on information and the press.
- * redistribution of petrodollars to the Venezuelan poor in the form of food, health, and education programs.
- * an emigration wave of the Venezuelan middle class to Argentina, Peru, Paraguay, and the United States.
- * the construction of Russian armament and munitions factories on Venezuelan soil.

- * acquisition of Russian, Chinese, Iranian, and North Korean long-distance missile technology.
- * pursuit of nuclear capabilities in cooperation with Iran, Russia, and North Korea.
- * pursuit of continental dominance, extending its reach into Cuba

In the coming months, Venezuela will increasingly use its role as the fourth-largest oil supplier to the United State to exert political pressure.

We believe the direct beneficiaries of this development will be US-based companies with oil assets unaffected by the future South American and present African and Middle Eastern crisis points. Among our favorites is **Apache Energy (APA-NYSE)**, which currently trades close to our recommended entry price in the mid-\$60s.

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November 22, 2006

[Happy Thanksgiving](#)

by J. Christoph Amberger

You learn about great migrations in history class at school. They were great, cataclysmic events that left behind areas stripped bare of food and life. Some of them pushed the great empires of antiquity near collapse.

But the great migrations of antiquity typically involved a couple of ten thousands souls -- a hundred thousand at best -- who laboriously moved from northern Europe across the Alps into the Roman heartland.

Compare this to the annual migration that is unleashed the day before Thanksgiving. According to AAA, 38.3 million Americans are about to travel at least 50 miles from home. Five million of them will be taking an airplane, and almost two million will board a train.

But there will be almost 32 million travelers on the roads paying an average of \$2.23 for a gallon of gas. That's more people than the entire population of Canada nibbling on Slim Jims and beef jerky, sipping lukewarm Sprite and listening to a constant chirrup of "Are we there yet?" emanating from the back bench -- while 70 million more people are scooting over their living room floors with a wad of paper towels and a can of carpet cleaner, manically rubbing at mystery spots that have suddenly appeared.

Until Monday, this means that trading volume at the American stock exchanges will be small. Moves in stock prices and indexes will be tame... representing a last breather before the December shopping season will set off the final market rally of 2006.

Based on the numbers for disposable income and initial sales for some of the hot Christmas gift items -- Playstation 3 and the new and improved Tickle-me-Elmo are already sold out in most places -- the shopping season will break new records. No small feat considering the previous three already have broken consecutive records.

I believe we could see the Dow clocking in at over 12,500 before 30 million Americans, driving cross-country to visit relatives over the Christmas holidays, will merrily join into the chorus of "For crying' out loud, turn that junk off" as Grandma got run over by a reindeer emanates from the car radio for the fifth time in half an hour.

Have a Happy Thanksgiving!

November 22, 2006 | [Permalink](#) | [Comments \(0\)](#) | [TrackBack \(0\)](#)

November 17, 2006

Strategic Investing

by J. Christoph Amberger

Another day, another record week for the Dow. While other US indexes dipped lower after the past week's run-up, the Dow Jones Industrial index overcame this morning's bets on a lower close, pushing forward into new uncharted territory. Oil and natural gas continued to decline as the Fall of 2006 turns out to be a mild one. (I hope it keeps up because I'm planning some serious hiking with my boys' Scout troop this weekend!)

Given falling prices for the commodity, I think Gazprom's hovering around the \$44 per ADR level is an indication of strength. Independent of the North American climate, a cold winter in Europe could again propel this stock upward in the short and medium term. The same goes for our domestic oil and gas cornerstone Apache Energy, which is currently trading around \$65.

But don't get me wrong here. Taipan recommendations like Gazprom and Apache are not short-term trend plays. We selected them after long deliberation as parts of a long-term strategic portfolio for which short-term percolations in the stock price really shouldn't matter.

Our strategic holdings are a bit different from what you frequently see from our editors at the Taipan Group. Most of us here are dyed-in-the-wool traders who like nothing better than making a quick buck or two on the short-term ups and down of a stock or index. But if you look at the performance of all kinds of assets, it becomes apparent that all of them have long, annoying periods of do-nothing performance. You may generate substantial profits here and there by trading -- or even by medium-term investing. But the only mega-periods where you actually make serious money occur maybe once in a decade -- sometimes just once every three decades.

To accurately determine the annual gains generated in our trading services, we apply a compound gains method: While each trade may have "only" generated AVERAGE gains of five, ten, or fifteen percent, the fact that you were able to make these average gains on fifty or over 100 in-and-out trades adds up to impressive short-term speculative returns if calculated over a year.

If you apply the cumulative gains strategy to long-term assets, you obtain quite a different perspective on the true meaning of long-term investing.

Houses work like that. Unless you have a hyper bull market like we had since 2002, your gains are typically marginal and hard to actually realize.... 3% here, 1% there, maybe even negative growth for a couple of years. Even a 20% gain p.a. in home prices is just a 20% gain... maybe just 15% once the realtor and the title company and your lawyer has walked away with their fees. But the

But a strategic long-term outlook adds up all those minute gains and eventually comes up with incredible numbers... the stuff that turns a 5,000 house into a 500,000 house. If you time it right and inflation doesn't rob you blind in the meantime.

The stock indexes work like that, too. Big Picture investor actually dollar-cost average and increase their profit potential with every buck they plows into depressed indexes. Maybe year-over-year, they generate 5% here and 2% there and -2.5% there. Then, suddenly, the decennial bull sets in. Any 10% gain in your portfolio is suddenly the equivalent of \$100,000.

These are the kind of stocks we like to put into our Strategic Portfolio... and keep adding to our positions much like we add to the equity in our houses by paying our mortgages.

Outlook: Inflation 2007

by J. Christoph Amberger

"Fear of inflation" is a rationalization for market dips trotted out by mainstream media pundits to explain daily fluctuations in the major stock indexes.

Inflation reflects the increase in prices for goods and services as measured against a predetermined baseline in purchasing power. Thus, it has as many fathers as success is reputed to have, among them the cost of borrowing, the cost of commodities, the price of energy, and the cost of labor.

Supply-side economics assumes as a fact that that inflation is caused either by an increase in the money supply or a decrease in the demand for money. As long as the demand for money also grows, money supply can grow without causing inflation.

Keynesians, however, believe in reducing demand in general, usually through higher taxation and other fiscal and political means.

In the coming years, we will see a shift back toward Keynesian thinking again. Increased taxation will reduce domestic demand as well as the capital that can be invested. As a consequence, unemployment will begin to rise, relieving the current tight supply of labor. Due to increasing competition for fewer jobs, overall labor cost will decline... further reducing spendable money and demand.

While the cumulative effect of this process is bad for Americans trying to make a living, this actually will be positive for the international competitiveness of the American economy. Lower domestic labor cost may even slow the rate of outsourcing jobs to China, India, and Mexico. With the American economy on the Bush Boom, employment costs have risen 3.3% in the past year alone, the fastest year-over-gain in five quarters -- beating the rise of inflation (which came in at 2.1% for the twelve months ending December 30.)

The global economy has a principally deflationary effect on prices. Its main commodity is cheaper labor. And as labor constitutes a larger share of a product's overall cost than the natural resources and energy used for its production, business will continue to try and reduce cost by opting for cheaper labor. Currently, the lions share of that cheap labor is provided by China. But competitors such as Vietnam and India are already aiming at giving the Chinese a run for their money... by offering labor whose overall cost may be even cheaper. The competition to offer the lowest labor cost -- even by subsidizing that labor directly or indirectly -- will guarantee that prices especially for manufactured products will continue to decline.

The same goes for commodities. Here, global competition and the Internet's global integration of the market may not eliminate rising prices due to supply and demand. But overall, the trend has been toward a more efficient market... which at its core, due to increased choice and competition among suppliers has a fundamentally deflationary effect.

The main culprit in last year's run-up in US inflation rates were energy prices. While the possibility -- and given the increased potential for Middle Eastern turmoil -- probability for further speculative hikes in energy prices remain, I believe we will see a retracement of =energy prices more often than we will see a rise over the next 12 months.

The effects of declining energy prices in particular can be amazing: Inflation at the wholesale level plunged at a record pace in October, led by big declines in the price of gasoline and new cars. Wholesale prices fell 1.6 percent in October, tying the record decline set in October 2001, the Labor Department reported Tuesday. It was the second consecutive big decrease, following a 1.3 percent fall in September.

Both months were heavily influenced by falling energy prices. But underlying inflation pressures were held at bay last month as well. Core inflation, which excludes energy and food, dropped by 0.9 percent, the biggest one-month fall in 13 years. That reflected big declines in prices for new cars and sport utility vehicles as dealers brought back sales incentives. Energy prices dropped by 5% last month following an 8.4% decline the previous month. Gas prices were down 7.9% and natural gas plummeted a record 9.3%.

Practically, this means one thing and one thing only: Don't expect any further rate hikes from the Fed any time soon! In fact, as the US economy begins to slow again after the Christmas boom of 2006 and the effects of bonus season, we believe that the Fed will start cutting rates again by May 2007.

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Location, location, location

by J. Christoph Amberger

More bad news for US real estate: US housing starts for October dropped to the lowest level in more than six years. Builders broke ground on new houses at an annualized rate of 1.486 million -- reflecting a precipitous decline of 14.6 percent over September. Building permits, an indicator of future building activity, dropped to a 1.535 million clip for a record ninth straight decline. Permits now are the lowest level since December 1997.

The decline in new building reflects a huge overhand of unsold inventory.

New housing starts are down 27 percent from 2005. Especially new construction of single-family homes was hit hard, dropping 16 percent in October.

While the southern United States experienced a 26 percent drop in the South, housing starts fell 12 percent in the Midwest and just 2.1 percent in the West. Construction actually rose by a solid 31 percent in the Northeast.

Which indicates again that even the ongoing deflation of the US real estate bubble is mainly a matter of location, location, location.

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Reaganisms

With the powershift in American politics, and the preceding years of compromising the core beliefs of the Republican party, it may serve us well to recall some classic quotes from Ronald Reagan:

"Here's my strategy on the Cold War: We win, they lose."

"The most terrifying words in the English language are: I'm from the government and I'm here to help."

"The trouble with our liberal friends is not that they're ignorant: It's just that they know so much that isn't so."

"Of the four wars in my lifetime none came about because the U.S. was too strong."

"I have wondered at times about what the Ten Commandments would have looked like if Moses had run them through the U.S. Congress."

"The taxpayer: That's someone who works for the federal government but doesn't have to take the civil service examination."

"Government is like a baby: An alimentary canal with a big appetite at one end and no sense of responsibility at the other."

"The nearest thing to eternal life we will ever see on this earth is a government program"

"I've laid down the law, though, to everyone from now on about anything that happens: no matter what time it is, wake me, even if it's in the middle of a Cabinet meeting."

"It has been said that politics is the second oldest profession. I have learned that it bears a striking resemblance to the first."

"Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

"Politics is not a bad profession. If you succeed there are many rewards, if you disgrace yourself you can always write a book."

"No arsenal, or no weapon in the arsenals of the world, is so formidable as the will and moral courage of free men and women.

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